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December 2, 2011

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Jocelyn Boyd
Chief Clerk and Administrator
South Carolina Public Service Commission
P.O. Drawer 11649
Columbia, SC 29211

Re: Kiawah Island Utility, Inc.
Our File No.: 5435-007

Dear Ms. Boyd:

Pursuant to the Commission's request at the Hearing held on November 30, 2011, I have enclosed the following revised pages of John Guastella's Direct Testimony and Supplemental Rebuttal Testimony:

1. Page 10 of Direct Testimony;
2. Pages 2, 5, 9, and 12 of Supplemental Rebuttal Testimony.

With kind regards, I am,

Sincerely,

PRATT-THOMAS WALKER, P.A.

G. Trenholm Walker

Enclosures (As Stated)
GTW\njdm
c: F. David Butler, Esq.
Jeffrey M. Nelson, Esq. (ORS)
Shannon Bowyer Hudson, Esq. (ORS)
Michael A. Molony, Esq. (KPOG)
Jason Scott Luck, Esq.

MR. GUASTELLA: Yes. The services provided under the management agreement, as explained by the Company witnesses, are an essential and necessary cost of operating a water and sewer utility. In my opinion, they are not only reasonable but conservative. While other costs have dramatically increased in the ten years since the last rate increase, the level of management fees has remained unchanged. Despite the other cost increases, the overall projected rate increase is relatively small in terms of average annual increases, part of which is reasonably attributable to good management. Clearly, the Company has been providing excellent service that is also attributable to good management. Moreover, when I compared the Company's payroll expenses in relation to total Operation & Maintenance Expenses with other utilities, they are significantly lower, see Schedule A-4. The Company's ratio of payroll to total operation and maintenance expenses is 15.5% as compared with 36.4% for companies in the Southeast Region, a very impressive statistic because KIU is much smaller than the other companies. Even if I add $100,000 of management fees to KIU's $604,750 payroll expenses, the ratio of payroll to total operation and maintenance expense is only about 18%. In my opinion, the Company's management fees are not and should not be noteworthy, except that they are relatively low, and water and sewer service is nevertheless excellent.

It is also worth noting that the ratio of payroll to total operation and maintenance expense has increased for the other companies since the last case -- it was about 29% for the Southeastern Region and is now about 36.4%. KIU's ratio was about 19% in the last case, and is now only 15.5%.

MR. WALKER: In your opinion, are the proposed rate increases for KIU's water and sewer operations reasonable?

MR. WALKER: Have you examined the prefiled direct testimony and exhibits of Ms. Ellen Blumenthal and Mr. Lynn Lanier, both with the consulting firm of GDS Associates, Inc. and Mr. William D. Rogers, Vice President and Treasurer of American Water Works Corporation ("AWW"), filed on behalf of the Kiawah Property Owners Group ("KPOG")?

MR. GUASTELLA: Yes.

MR. WALKER: What are the issues or areas of KPOG's witnesses' testimony with which you disagree, in general?

MR. GUASTELLA: Certain primary recommendations of the witnesses depart from the rate setting standards, policies and methodology that has been established by the South Carolina Public Service Commission ("PSC" or "Commission") and the Office of Regulatory Staff ("ORS"), which have been previously applied to KIU. They also raise issues that have been addressed in court decisions confirming the Commission's decisions regarding the same issues. In some instances, the witnesses state opinions which they do not support with adequate analysis, or in some instances any analysis, and offer opinions which are contrary to well established rate setting principles, practice and methodology.

MR. WALKER: **What is the most important analysis that the KPOG witnesses fail to provide regarding developer-related water and wastewater utilities?**

MR. GUASTELLA: They fail to describe the economic differences between the real estate business in which the price of real estate reflects its market value determined in a competitive, unregulated environment, and utilities that are natural monopolies subject to rate regulation by state agencies that serve as a substitute for competition. KPOG's witnesses fail to describe how economic regulators should recognize these differences in setting water and sewer rates, and fail retroactively impacted the prices charged for real estate, by denying KIU's stockholders a reasonable return of and on its investment in the KIU.

MR. WALKER: Do you agree with Ms. Blumenthal's statement on page 4 of her testimony that, "In setting utility rates, affiliate costs should be presumed to be unreasonable and excluded from the determination of rates and only the amounts that the utility demonstrates are reasonable and necessary should be included?

MR. GUASTELLA: No. All utility costs, including those direct or allocated costs of affiliates incurred in the operation of the utility, should be examined as to their reasonableness. Regulators cannot and should not disallow costs simply on the basis of a presumption that they are unreasonable, but only if after examination of the costs and application of appropriate rate setting standards they are specifically found to be unreasonable.

MR. WALKER: Do you agree with Ms. Blumenthal's recommendation to disallow the cost of land and certain payments for sewer lines?

MR. GUASTELLA: No. With respect to the land, Ms. Blumenthal states that "KIU has provided no support for the assets it purchased or for the price it paid" and with respect to the sewer lines she states that they should have been contributed, "….as is customary in the industry. In my opinion, this would not have occurred were KIU an independent utility, rather than a developer owned one." First, the land and sewer lines are an integral part of KIU's backbone plant that is used and useful in providing service. As for support, KIU's financial statements and schedules submitted in support of the rate filing provide the typical data regarding utility assets. Ms. Blumenthal states that the financial statements show that the price of the land was at fair market value. The market value of the land, previously leased, was based on appraisals. Ms.

MR. GUASTELLA: There are several:

1. The FPSC allows fully projected test years, with an eight month not a six month process. In Florida the KIU's Phase II increase would not become effective in May 2012. Mr. Lanier's calculation of the FPSC leverage graph for the return on equity is based on KIU's rate base without projections and, therefore, would be accurate for the FPSC allowed projected test year. The correction would increase Mr. Lanier's recommended return on equity from 10.6% to over 11%.
2. In Florida, temporary rates are automatically granted within 60 days of filing, without hearings, based on the latest historical operating results. Accordingly, if under FPSC jurisdiction, KIU's customers would have begun paying about $70,000 per month beginning about October 2011 and until permanent rates are established.
3. The FPSC allows automatic pass through rate increases for inflation, purchased water, power and ad valorem taxes. If under Florida jurisdiction, KIU's customers would have been paying about $30,000 more in 2011 than under South Carolina PSC jurisdiction.
4. If I apply the FPSC's policies, rules, regulations and statutes to KIU, from October 2011 through September 2012, and assuming in South Carolina the rates will become effective in February, KIU's customers would have paid about $600,000 more than in South Carolina.

MR. WALKER: Is there anything else significant about the FPSC and South Carolina PSC jurisdictions that Mr. Lanier doesn't mention?

more reasonable for his companies. First, the AWW companies' investment in source of supply, treatment, pumping, storage, mains, hydrants, meters and services seem to me to be no more complex than KIU's investment in similar facilities. The major difference is that KIU's operations are considerably more sensitive to earnings erosion than the AWW companies because a small change in operating expenses, say $200,000 for rate case expenses, represent about 3.5% of operating expenses whereas it would be less than 0.2% for many of the AWW companies. Mr. Rogers recommends an operating margin of 7% for KIU -- which would produce only about a 6% return on equity. It is my opinion, that small utilities require higher rates of return than larger utilities, an opinion I know is shared by most who are involved in the regulation of small water and sewer utilities. Mr. Rogers' recommendation of a 7% operating margin, or a 6% equity return, is unreasonable, particularly in light of the need to finance the new water line.

Mr. Rogers states that it is appropriate to recognize growth, with no estimate of his own. KIU did recognize growth, so there seems to be no point to his observation.

Mr. Rogers states that it is highly unusual for developers to charge utilities for infrastructure, citing a single payment to another unregulated utility. It has been my experience in regulating and consulting for hundreds of developer-related water and sewer utilities, many of which I helped establish, that except for voluntary contributions of distribution and collection systems, the developers make investments in their utilities, the assets of which are transferred to the utility with payments made or reflected as an intercompany account or paid in capital. Mr. Rogers testimony in this regard seems to lack an understanding of developer-related utilities, and he offers opinions without adequate analysis.